STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions of **WILLIAM G. HALBY** for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and New York City Personal Income Tax under the Administrative Code of the City of New York for the Years 2002 through 2005.	DECISION DTA NOS. 821494 AND 821810

Petitioner, William G. Halby, filed an exception to the determination issued by the Administrative Law Judge dated September 18, 2008. Petitioner appeared pro se. The Division of Taxation appeared by Daniel Smirlock, Esq. (Kevin R. Law, Esq., of counsel).

Petitioner filed a brief in support of his exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on March 24, 2010 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the Division of Taxation properly disallowed petitioner's claimed itemized deductions of medical expenses for amounts paid for erotic materials, sexually related publications, male enhancement pills, and miscellaneous services performed by prostitutes.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

In August 2005, the Division of Taxation (Division) commenced an audit of petitioner's resident income tax returns for the tax years 2002, 2003 and 2004. Specifically, the audit was limited to an examination of the federal medical expense deductions taken for such years by petitioner.

For the 2002 tax year, petitioner claimed a medical expense deduction of $105,271.00, after the 7.5% limitation on federal adjusted gross income (AGI). Included among the medical expenses claimed was an expense of $111,364.00, of which $40,588.00 was categorized on an attachment to Schedule A on petitioner's federal return as "therapeutic sex"[1] and $70,776.00 as "massage therapy to relieve osteoarthritis and enhance erectile function through frequent orgasms." Also included as part of the medical expense deduction claimed were the sums of $658.00 for medical books, videos and periodicals and $2,173.00 for "pornography to enhance sexual performance in lieu of taking Viagra."

In the Division's field audit report, in the explanation of adjustments, the auditor stated as follows:

> The $111,364 of expense for sexual activities with prostitutes is being disallowed as an itemized deduction for medical expenses because these expenses are not deemed to be allowable medical expense deductions. Also, the expenses incurred are illegal in New York State. Illegal treatments cannot be included in medical expenses. In addition to being illegal in New York State, these expenses are not substantiated with receipts. In addition, $2,160 and $658 of expenses that were primarily pornographic or sexually related are also not allowed as a medical expense because these expenses are not deemed to be allowable medical deductions. In addition, some of these expenses are not substantiated with receipts.

For the 2003 tax year, petitioner claimed a medical expense deduction of $101,930.00, after the 7.5% limitation on federal AGI. Included in this amount was the sum of $4,015.00 for

[1] In explaining this therapeutic sex, petitioner quoted certain books and publications that cited medical benefits resulting from using surrogate sex partners.

medical books, magazines, videos and pornographic material used to enhance sexual performance, the sum of $103,758.00 for therapeutic sex, genital massage and related expenses as well as $162.00 for sexual performance aids (lubricants, condoms and nipple clamps) and $431.00 for male enhancement pills.

The auditor disallowed $101,126.00 in expenses for sexual activities with prostitutes, $3,654.00 in "expenses that were primarily pornographic or sexually related," and the $162.00 for "sexual performance aids" and $431.00 for male enhancement pills. The audit report again noted that the expenses for sexual activities with prostitutes and some of the other expenses claimed were not substantiated with receipts. The auditor also disallowed $2,632.00 of interest expense claimed because interest expense is not allowed as a medical expense and personal interest expense is not deductible.[2]

For the 2004 tax year, petitioner claimed a medical expense deduction of $70,760.00, after the 7.5% limitation on federal AGI. Of this expense, $65,934.00 was claimed for massage therapy, genital massage and therapeutic sex and related expenses for condoms, lubricants and male enhancement pills. In addition, petitioner claimed an expense of $2,368.00 for medical books, magazines, videos and pornographic material used to enhance sexual performance. Petitioner also claimed an expense of $5,632.00 for bank and credit card finance charges incurred in connection with loans needed to pay for these services.

The auditor disallowed the $65,934.00 as sexual activities with prostitutes and the expenses claimed because they are not deemed to be allowable medical deductions. The audit report noted that illegal treatments cannot be included in medical expenses and that the expenses

[2] It is unclear where this $2,632.00 is derived from. Unlike petitioner's 2004 return where an interest and finance charge expense is claimed on an attachment to Schedule A, no such expense appears on the attachment to Schedule A on his 2003 return.

were not substantiated with receipts. As to the $2,368.00 claimed, the auditor determined that such expenses were primarily pornographic or sexually related and are not allowable as a medical deduction. Finally, the auditor disallowed the $5,632.00 of bank and credit card finance charges on the basis that such charges are not allowed as a medical deduction and that personal interest expense is not deductible.

On January 30, 2006, the Division issued a Notice of Deficiency to petitioner which asserted the following deficiencies:

Period Ended	Jurisdiction	Tax	Interest	Penalty	Total Due
12-31-02	NYS	$6,269.00	$1,225.00	$927.00	$8,421.00
12-31-02	NYC	$3,352.00	$657.90	$504.45	$4,514.35
12-31-03	NYS	$4,473.00	$559.26	$505.13	$5,537.39
12-31-03	NYC	$2,475.00	$313.09	$279.04	$3,067.13
12-31-04	NYS	$386.00	$22.95	$30.47	$439.42
12-31-04	NYC	$966.00	$58.38	$79.69	$1,104.07
TOTAL		$17,921.00	$2,836.58	$2,325.78	$23,083.36

By a Conciliation Order (CMS No. 213123) dated December 1, 2006, the Division's Bureau of Conciliation and Mediation Services (BCMS) canceled the penalties asserted in the Notice of Deficiency dated January 30, 2006. The additional tax asserted in the Notice of Deficiency remained unchanged with interest computed at the applicable rate.

For the year 2005, petitioner timely filed his resident income tax return. On the return, he claimed itemized deductions totaling $44,035.00 which, on his petition filed for such year, he addressed as follows:

> [t]he expenses were for sexual massage therapy and therapy-related materials and represented an internationally recognized form of medical care for the treatment of geriatric depression and maintenance of sexual

function. The nature of the expenses was fully disclosed on the Federal return.[3]

The expenses were essential for Petitioner's health and were substantiated by contemporaneous records maintained by Petitioner.

Based upon his 2005 return with itemized deductions claimed in the amount of $44,035.00, petitioner claimed a refund due of $1,308.00.

On May 15, 2006, the Division advised petitioner that his 2005 New York State income tax return had been selected for review and that additional information was required to verify the accuracy of his refund claim. The Division asked for copies of bills, receipts, canceled checks and credit card receipts for the medical expenses claimed on the return.

On October 23, 2006, the Division issued a Notice of Deficiency to petitioner asserting State and City tax due in the amount of $1,136.50, plus interest, for a total due of $1,188.81 for the tax year ended December 31, 2005.

For the 2005 tax year, it is stipulated by and between the parties that:

a. The amount deducted from petitioner's Social Security benefit as a monthly premium for Medicare B supplemental medical insurance in the year 2005 was $78.20 ($938.40 for the year);

b. Petitioner's combined monthly after-tax contribution to his former employer's health care and dental plans in the year 2005 was $28.87 ($346.44 for the year);

c. Petitioner paid $21.94 to Ophthalmology Associates of Bay Ridge, Brooklyn, New York, in the year 2005 for the services of an eye doctor; and

d. Prescription drugs purchased by petitioner from Rite Aid Pharmacy for the year 2005 totaled $60.64.

---

[3] Petitioner's 2005 federal return is not a part of the record herein.

As of the date of the hearing held in this matter, petitioner was 76 years old and was retired and living alone. Petitioner was a graduate of the University of Michigan with a Bachelors Degree in letters and law, and he received a Juris Doctor Degree from the University of Michigan Law School in 1955.

For the years at issue, petitioner, in support of the services claimed as a medical expense deduction, provided schedules with dates, first names and amounts allegedly paid for "sensual massage and surrogate sex therapy." In his brief, he stated that the disallowed expenses "represented cash payments to unlicensed caregivers for whole body massage and included a genital massage to orgasm with ejaculation by hand." Petitioner admitted that there are no licensed caregivers who provide the services for which he has claimed a medical expense deduction. He enlisted the unlicensed caregivers' services through advertisements in local newspapers. Petitioner stated that the services provided consisted mostly (approximately 90%) of massage and, in a few cases, intercourse.

The auditor requested backup materials such as receipts to substantiate the expenses claimed; however, petitioner informed the auditor that no receipts existed because receipts are not generally given by such providers, often due to a fear of prosecution, and that the names of the service providers listed in petitioner's schedules may not have been the real names of such providers.

For the 2002 and 2003 tax years, petitioner introduced into evidence a copy of a notebook entitled "Tax Journal," which contained dates, the first names of service providers and amounts allegedly paid to such providers. No other substantiation of these payments was provided. No receipts for any of the books, magazines, videos or sexual performance aids were provided; no mention of these items was made in the "Tax Journal." For the 2004 and 2005 tax years,

petitioner introduced a copy of a similar notebook that set forth dates, first names of service providers and amounts allegedly paid to the providers. In addition, this notebook contained the dates and amounts allegedly paid for books, videos and magazines; no receipts for these items were included.

Petitioner provided the auditor with copies of his federal returns for the years at issue. The medical expense deductions claimed thereon as itemized deductions matched the deductions claimed on his State and City returns for these years. As a result of the audit that the Division commenced for 2004 (and then extended to include 2002 and 2003 as well), the Internal Revenue Service (IRS) instituted an audit of petitioner for the years 2004 and 2005.[4] Petitioner indicated that his case was pending in the U.S. Tax Court, but no trial date had been set.

For the year 2002, the Division allowed $1,606.00 of the $105,271.00 claimed as a medical expense deduction, which represented payments for doctor visits, Medicare premiums, insurance premiums and prescription drugs. Similarly, for 2003, the Division allowed $2,322.00 of the $101,930.00 claimed by petitioner. For 2004, of the $70,760.00 claimed, the Division allowed $2,380.00.

By letters dated March 19, 2007 and April 1, 2007, petitioner made a motion that the record in this proceeding be sealed or, in the alternative, that he be permitted to proceed anonymously. On April 9, 2007, Chief Administrative Law Judge Andrew F. Marchese responded to petitioner's letters and suggested that petitioner renew his motion at the hearing held in this matter. Petitioner did, in fact, make the motion at the hearing and, in addition, addressed the issue in his brief submitted subsequent thereto.

---

[4] Petitioner stated that he was not audited by the IRS for 2002 and 2003 for the apparent reason that the statute of limitation for those years had either expired or was soon to expire.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The first issue addressed by the Administrative Law Judge was petitioner's request to have the record sealed in this matter or, in the alternative, to allow petitioner to proceed anonymously. The Administrative Law Judge determined that the regulations do not provide the Division of Tax Appeals with the authority to seal the record. With respect to proceeding anonymously, the Administrative Law Judge noted that the courts have discretion to grant such a request in an attempt to balance the privacy interests of a party with the constitutional presumption of openness in judicial proceedings. In this case, the Administrative Law Judge stated that petitioner made a voluntary challenge to the Division's disallowance of itemized medical deductions for the purchase of prostitution services and pornographic materials. As there is no public interest served by maintaining petitioner's confidentiality, but rather, an attempt to avoid embarrassment, petitioner has not demonstrated good cause to grant his request to proceed anonymously. Therefore, the Administrative Law Judge denied petitioner's request. Petitioner did not file an exception with respect to this issue.

Next, the Administrative Law Judge considered whether the Division properly denied petitioner's claimed medical expense deductions for the years at issue. The Administrative Law Judge noted that petitioner bore the burden of demonstrating entitlement to the deductions and to substantiate the amount of the deductions. The Administrative Law Judge stated that the expenses incurred by petitioner were not paid to medical professionals nor were such activities provided by medical professionals. In fact, the Administrative Law Judge emphasized that the moneys paid were to unlicensed providers for illegal activity and, as such, were not allowable medical expenses. The Administrative Law Judge further commented that even if such expenses were hypothetically paid over to medical professionals, such expenses were incurred for

petitioner's general well-being rather than for the cure, mitigation, treatment or prevention of a specific disease or condition. As such, the Administrative Law Judge concluded that petitioner failed to establish that these expenses were for prescribed medical activity.

Moreover, the Administrative Law Judge determined that petitioner failed to substantiate the claimed amounts of the expenses. The Administrative Law Judge noted that petitioner did not submit any receipts, cancelled checks, credit card statements or other evidence other than his own notebook. Thus, the Administrative Law Judge held that the Division properly denied the claimed medical expenses described herein.

The Administrative Law Judge then addressed petitioner's argument that the Division was prohibited from disallowing his claimed itemized deductions, which were based upon deductions that he claimed on his federal income tax returns, in the absence of an IRS determination disallowing such deductions. The Administrative Law Judge noted that Tax Law § 697(b)(1) authorizes the Division to conduct independent audits of any return in order to verify whether a filed return is correct. The Administrative Law Judge stated that the Division is not mandated to accept petitioner's itemized deductions as set forth on his relevant federal returns just because the IRS did not conduct its own audit. Thus, the Administrative Law Judge rejected this argument. Petitioner did not take an exception with respect to this issue.

The last issue before the Administrative Law Judge was petitioner's argument that Tax Law § 615 required the Division to accept itemized deductions claimed on a federal return and that the Division has no authority to withhold a refund claimed on the state return in the absence of a prior assessment of state tax. The Administrative Law Judge reiterated his reliance on the statute that provides the Division with the authority to conduct its own independent audits. Moreover, the Administrative Law Judge stated that prior to the Division selecting petitioner's

2005 return for review, the Division had already audited petitioner for the same issue for the years 2002 through 2004. The Administrative Law Judge determined that the Division was well within its right to initiate an audit for 2005 when petitioner claimed a deduction for the same items that had been disallowed for the years 2002 through 2004. Thus, the Administrative Law Judge rejected petitioner's contention that the Division did not have the power to withhold the refund claimed on his 2005 State return. Petitioner did not take an exception with respect to this issue.

ARGUMENTS ON EXCEPTION

Petitioner continues to claim that the services that he paid for were medical in nature for the cure, mitigation, treatment or prevention of disease and not simply for his general well-being. Petitioner reiterates his reliance on general medical articles to support his position. Petitioner excepts to the Administrative Law Judge's conclusion that the services rendered to him were in violation of the Penal Law. Lastly, petitioner argues that he has substantiated the amounts of his expenses. Petitioner states that his contemporaneous record "satisfies the necessity of proof for tax purposes under the business records exception to the hearsay rule [citations omitted]" (Exception, p. 2A, ¶4).

In opposition, the Division respectfully requests that the determination be affirmed in all respects.

OPINION

We affirm the determination of the Administrative Law Judge.

Subsequent to the issuance of the determination below, the United States Tax Court issued its decision in ***Halby v. Commissioner*** (98 TCM 194 [2009]). In his federal proceeding, petitioner sought identical medical expense deductions for the tax years 2004 and 2005 as are

claimed herein. Similar to the Administrative Law Judge's conclusion in the case before us, the Tax Court held that petitioner was not entitled to the deductions. The Tax Court stated that patronizing a prostitute is illegal in New York and, thus, a taxpayer cannot claim a deduction for any illegal operation or treatment (***see***, Treas. Reg. 1.213-1[e][1][ii]). The Tax Court held that: "Petitioner's payments to various prostitutes were personal expenses not prescribed by a doctor and not intended to treat a medical condition" (***Halby v. Commissioner***, ***supra***). Moreover, it was determined that the moneys paid for books and magazines on sex therapy and pornography were not for the treatment of a medical condition, but rather, were instead personal items.

Thus, we find that the Administrative Law Judge adequately and correctly addressed the issues presented to him. Additionally, the federal proceeding reached the same conclusions as that determined by the Administrative Law Judge. Therefore, we conclude that the Division properly disallowed the claimed itemized deductions.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of William G. Halby is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of William G. Halby are denied; and

4. The Notice of Deficiency dated January 30, 2006, as modified by Conciliation Order CMS No. 213123, and the Notice of Deficiency dated October 23, 2006 are sustained.

DATED:Troy, New York
September 23, 2010

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner